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Chairman David Walker
Commercial Activities Panel
General Accounting Office
441 G Street, N.W., Room 7476
Washington, DC 20548

Chairman Walker and Panel Members:

I regret that I cannot present this testimony today in person. As Senior Fellow at the Council on Foreign Relations and a University professor and economist with expertise in defense economics, I have been researching outsourcing and privatization intensively for three years. I offer you this brief summary of my findings, which are based on a reading of the literature, several sessions of my Council on Foreign Relations study group, and interviews and discussions with dozens of middle level military officers, Pentagon managers, and private sector contractors. My conclusions are my own and do not >represent those of the Council or the University of Minnesota. In brief, my scholarly work finds as follows.

National defense is already among the most heavily outsourced of activities in the federal government. The ratio of private sector jobs to civil service jobs in DOD is nearly five to one and has been increasing over the decades, far in excess of non-defense-related agencies. There is no solid evidence that outsourcing has lowered costs in the longer run or solved the problem of persistent cost overruns. Nor has it encouraged fiscal austerity in defense budget requests.

The benefits of outsourcing occur only under certain rather rigorous circumstances. My review of the research on outsourcing of K-12 education, city services and prisons finds emphatically that it is competition, not outsourcing, that evokes superior performance in terms of service quality and cost containment. Even with effective competition, outsourcing requires public sector managers and employees to set ground rules, generate and maintain competition, draw up contracts that are clear and with verifiable performance standards, and oversee outcomes. In the realm of national defense, such conditions do not generally prevail except for the most routine activities, for three reasons. First, except for the most routine of services, full scale competition is unlikely to exist or persist beyond a single round. Creating and maintaining competition is a formidable and expensive task. Second, setting out clear performance standards is quite difficult for many defense goods and services, many of which involve long-term relationships and a great deal of back-and-forth experimentation between the military user and the contractor. Third, monitoring and evaluating outcomes is complicated and extremely expensive. The Pentagon's ability to do so has been undermined by cutbacks in personnel and a growing inability to compete for the best talent in the market. Where these conditions are not met, contracting out will result in bilateral monopoly, cost overruns, and disappointing performance.

Public-private competitions have encouraged lower bids from both types of competitors. Public-private competitions can have salutary effects. Over the decades, the Department of Defense has conducted more A-76 competitions than most other agencies. The threat of outsourcing has encouraged Pentagon managers and armed service officers to pay greater attention to cost and performance, and the same is true for contractors in the few cases where they have had to compete with the public sector. However, the A-76 process only compares promised cost and performance data - no follow-up of actual savings is conducted. At the same time, the movement of activity from public to private sector can irrevocably remove from the Department of Defense expertise that would enable it to evaluate future bids and/or bring the work back in-house.

The potential for defense savings from outsourcing is largely driven by reductions in personnel costs. Some of this reduction may come from multi-tasking and smarter management, but most of it results from the ability to pay employees less in wages and benefits and from a greater reliance on temporary employees. It is impossible to fully determine just how much, because defense contractors are not currently required to share this information with government. Managers of privatized prisons do provide data on wages and benefits to state and federal governments - defense contractors should be required to do so as well. Most Americans, I believe, would not support outsourcing if they knew its savings resulted chiefly from redistributing from workers to stockholders and taxpayers.

The national security implications of outsourcing are troubling and under-explored. The case for outsourcing rests principally on purported cost savings and better quality defense goods and services. However, the risks of supply disruption (through bankruptcy or capital or labor strikes), fraud, corruption and erosion of in-house expertise pose greater problems than they would in non-defense sectors. Furthermore, as large contractors amalgamate larger shares of defense work, they become major political players, attempting, often successfully, to influence American military and foreign policy, spending levels and the composition of defense budgets through lobbying and campaign finance. The result may be very real distortions and inefficiencies in American national security.

Privatization initiatives must place the maintenance of competition, the assurance of adequate Pentagon oversight and national security risks at the center of the policy. Ceilings on public employment and quotas that must be met for future outsourcing violate economic logic. Eliminating or avoiding public/private competition squanders public resources and know-how currently in place and undercuts the Pentagon's ability to retain its competence as a buyer and user. The costs of oversight, including recruitment of first rate talent, must be built into the decision criteria in the outsourcing process, as should a premium for the associated risks and contingency costs.

I attach my full length study of these matters, "The Case Against Privatizing National Security," as an appendix to this testimony. I would be delighted to engage in further discussion with the panel and to share my work in greater depth. I believe your conclusions will be significant in shaping the future of the relationship

between public and private sectors in the arena of national defense. I urge you to focus on the thorny problems of how to maintain and enhance competition and how to assure the Department of Defense, as customer of outsourced goods and services and guarantor of national security for American citizens, adequate expertise and effective monitoring capabilities.

Regards,

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